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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 873

CHINA LIQUOR DISTRIBUTING CO., et al.
HULSE IMPORT CO., et al.,
Petitioners,

vs.

THE UNITED STATES,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Customs and Patent Appeals

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SUBJECT INDEX

Page

Opinion Below 1

Jurisdiction 2

Questions Presented 2

Trade Agreement and Statutes Involved 3

Statement 3

Reasons for Granting the Writ 8

The Court of Customs and Patent Appeals Has Rendered Article II of the General Agreement on Tariff and Trade an Empty Shell, and Its Holding Goes Contra to the Opinions Expressed by the Ninth Circuit Court of Appeals in Parrott and Co. v. United States, 156 F.2d 1943 8

Uncorrected, the Decision of the Court of Customs and Patent Appeals May Imperil the United States Trade Agreement Program 14

Conclusion 17

Appendix A ..... App. 1

Appendix B ..... App. 14

TABLE OF AUTHORITIES CITED

Cases	Pages
Altman v. United States, 224 US 583	5
Berent-Vandervoort & Co. v. United States, 46 CCPA 28	5, 7, 8, 9, 12, 13
China Liquor Distributing Co. v. U. S., 48 Cust. Ct. 217; 49 Cust. Ct. 208, Abstract 66985	7
Parrott and Co. v. United States, 156 F.2d 1943	8, 13
Select Wines Company v. United States, 31 Cust. Ct. 3110, Abstract 57648	13
United States v. Domestic Fuel, 21 CCPA (Customs) 600, TD 7010	8, 15, 16
United States v. Rathjen, 31 CCPA 70, C.A.D. 250	7, 12
United States v. Stone and Downer, 274 U.S. 225	9
Vernon Distributing Co. v. United States, 39 CCPA (Customs) 205, C.A.D 463	7, 12

Statutes	
Internal Revenue Code of 1939 as Amended, (26 U.S.C. 1946 ed., Supp. V):	
Section 2800	3, 4, 6, 7, 11, 13, 14
Section 2800(a)(1)	3, 4, 6, 11, 14, App. B 14
Section 2800(a)(4)(A)	16, App. B 14
Section 2800(a)(5)	7, App. B 15
Section 2800(b)(2)	13
Section 2809	App. B 16
Section 3254	7, App. B 16
Section 3350	13, App. B 17
Internal Revenue Code of 1954 (68 A Stat. 3, 395, as amended): 69 Stat. 14	3, 7, App.B 14-17

Pages

Revenue Act of 1932 47 Stat. (PT. I) 169, 260 16

Revenue Act of 1938, 52 Stat. 447, 572 12

Revenue Act of 1951, 65 Stat. 452, 524 ..... 2, 4, 5, 7, 8, 11, 17, App. B 17, 18

Section 451 ..... 17, App. B 17

Section 615 ..... 5, App. B 18

United States Code:

Title 28, Section 1256 2

Title 28, Section 1583 3

Other Statutes:

58 Stat. 61 and 16 Stat. 12 ..... App. B 14, 17

TRADE AGREEMENTS

Cuban Trade Agreement of 1934, 49 Stat. (Pt. II) 3559 12

Supplementary Cuban Trade Agreement, 54 Stat. (Pt. II) 1997 12

General Agreement on Tariffs and Trade, 61 Stat. (Pt. V) A5, A14-A15, A18, A1249; id. (Pt. VI) A2051; as amended 62 Stat. (Pt. III) 3680 ..... 1, 2, 3, 4, 5, 7, 8, 9, 10, 12, 13, 16, App. B 18, 19, 20

Article II ..... 2, 4, 5, 7, 8, 9, 10, 13, 16, App. B 18, 19

Article II (1)(a) 5

Article II (1)(b) ..... 4, 12, App. B 18

Article II (2)(a) ..... 4, 8, 13, 16, App. B 19

Article III ..... 2, 4, 8, 9, 10, 12, App. B 19

Article III (1) ..... 8, 9, 12, App. B 19

Article III (2) ..... 8, 12, 19, App. B 19

Protocol of Accession ..... 11, App. B 20

Schedule XX, Part I ..... 3, 5, App. B 20

Treaty with Great Britain of 1815, 8 Stat. 228 15

REGULATIONS

Page

26 Code of Federal Regulations (1949):
Sections 186.148 and 186.149 2

Sections 190.202 and 190.246 5

26 Code of Federal Regulations (1961), Section 201.426 7

27 Code of Federal Regulations (1961):
Section 5.21 5

Sections 1.20-1.22 6

OTHER AUTHORITIES

Analysis of the General Agreements on Tariffs and Trade, Department of State Publication 2983, Commercial Policy Series 109, November 1947, p. 196 9

Contracting Parties, General Agreement on Tariffs and Trade, *Basic Instruments and Selected Documents*, Volume 2, First Supplement, page 49 10

Hearings before the Committee on Ways and Means, House of Representatives, Eighty-Second Congress, First Session on HR 1535, pp. 651, 242, 28, 29 11

H.R. 1535, p. 651 11

The Summary of Tariff Information, 1948 (vol. 8, p. 44) 6

United States Tariff Commission, *Operation of the Trade Agreements Program*, Fourth Report (July 1950-June 1951, page 68 10

United States Tariff Commission, Washington, D.C., *Trade Agreements Digests*, Volume VIII, pp. 2, 13 6

In the Supreme Court of the United States

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No. .....

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vs.

THE UNITED STATES,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Customs and Patent Appeals

Petitioners whose names are listed in the Record pages 8-12 pray that a writ of certiorari issue to review the judgments of the United States Court of Customs and Patent Appeals.

OPINION BELOW

The opinion of the Court of Customs and Patent Appeals (Appendix A, *infra*, pp. 1-11) is reported in 99 Treas. Dec. 29 (C.A.D. 847); and will be reported in 52 C.C.P.A. (Customs) 1. The opinion of the Customs Court (R 228-38) is reported in 48 Cust. Ct. 217, motion for rehearing dismissed (R 241-243) in Abstract 66985, 49 Cust. Ct. 208.

JURISDICTION

The judgment of the Court of Customs and Patent Appeals (Appendix A, *infra*, pp. 11-12) was entered May 28, 1964, and a petition for rehearing was denied (Appendix A, *infra*, pp. 12-13), and denial entered on November 5, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. § 1256.

QUESTIONS PRESENTED

Imported bottles of underproof alcoholic beverages (enumerated by the General Agreement on Tariffs and Trade) are assessed the increase of $1.50 per gallon imposed by the Internal Revenue Act of 1951 on the wine gallon basis which results in their paying more than bottles of like domestic products which pay on the *proof gallon*.[1]

1. Does this disparity in assessment comply with Article II of the General Agreement on Tariffs and Trade which prohibits any increased charges after its effective date (January 1, 1948) unless the imposition (1) is a "charge equivalent" to a tax upon the like domestic product, or upon an article from which the import was made; and (2) is applied in accordance with Article III so as not to afford protection to domestic production?

2. What assessment under the Act of 1951, if any, is proper on imported bottles of underproof alcoholic beverages?

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1. A standard United States wine gallon contains 231 cubic inches. 26 CFRS (1949 ed.) section 186.148. A standard United States gallon containing 50 percent alcohol by volume and 50 percent water by volume would be 100 proof spirits and is known as a proof gallon. 26 CFR (1949 ed.) section 186.149.

Assessment of alcoholic beverages on the wine gallon basis means that each gallon pays $1.50 regardless of its alcoholic content; assessment on the proof gallon makes allowance for the extent to which the product is below or above proof. Thus an 80 proof gallon bottle would pay $1.50 on a wine gallon basis in contrast to $1.20 on the proof gallon.

TRADE AGREEMENT AND STATUTES INVOLVED

The pertinent provisions of the General Agreement on Tariffs and Trade, (61 Stat. (Pt. V) A5, A14-A15, A18, A1249; id. (Pt. VI) A2051; as amended 62 Stat. (Pt. III) 3680; and the pertinent provisions of Int. Rev. Code of 1939, as amended (26 USC (1946 ed.) Supp. V, 2800 (a)(1)),[2] and of the Revenue Act of 1951 (65 Stat. 452, 524), and of the Revenue Act of 1954, as amended (68A Stat. 3, 595, 69 Stat. 14) appear in Appendix B, *infra*, pp. 14-20.

STATEMENT

This petition is filed on the behalf of more than 200 Pacific Coast importers whose names are listed in the Record, pages 8-12. Their importations involved alcoholic beverages on which tariff concessions were made to the other contracting parties to the General Agreement on Tariffs and Trade at Geneva.

All the importations consisted of bottled underproof whiskey, cordials, rum, and other alcoholic beverages scheduled in the General Agreement. (Schedule XX, Appendix B). They were assessed at the rate of $10.50 per wine gallon under section 2800(a)(1) of the Internal Revenue Code of 1939 as amended (26 USC (1946 ed.) Supp. V, 2800(a)(1)) and by the Act of 1951 (65 Stat. 452). See Appendix B, pp. 14 and 17. Petitioner filed timely protests against the assessments which the Collector of Customs rejected (R 31, 32) and the case went to the United States Customs Court under the authority of 28 USC 1583.

The collector had made the assessments according to the formula in section 2800(a)(1) which levied the internal revenue tax on all domestic spirits on their alcoholic con-

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2. 2800 of the IRC of 1939, as amended, was superseded by 5001 of the IRC of 1954, 26 USC (1952 ed., Supp. IV) 5001, which contains substantively the same language.

tent when withdrawn from the domestic bonded warehouse but charged the full wine gallon rate on underproof bottled alcoholic beverages when imported.

The importers had advanced many claims in their protests (R-33, 88, 110) but in the Customs Court abandoned all which did not concern the $1.50 added by the Revenue Act of 1951 (65 Stat. 524) to the $9 assessment in force January 1st, 1948 when the General Agreement on Tariff and Trade (61 Stat. (Pt. V) A5) went into effect. They based their case on Article II of the General Agreement and the Act of 1951 itself.

Article II (1)(b) of that Agreement had exempted all the enumerated alcoholic beverages from any "charge of any kind imposed on or in connection with importation" in excess of those imposed on the date of the Agreement except as permitted by Article II (2)(a) of the same Agreement. They contended that the $1.50 assessment under the Act of 1951 was to be calculated not in accordance with the formula of section 2800(a)(1) of the Internal Revenue Code but of that prescribed by Article II (2)(a) of the General Agreement on Tariffs and Trade which specified that:

> a) the *charge must be equivalent* to an internal tax imposed *consistently* with the provisions of paragraph 2 of Article III *in respect to a like domestic product*. or
>
> b) in respect of an article from which the imported product has been manufactured or produced in whole or in part:

and by reference to Article III that:

> c) the "charge equivalent" must not be in excess directly or indirectly of the internal charges applied to such like domestic products.
>
> d) *nor so applied as to provide protection to domestic production.*

The Revenue Act of 1951, which increased the rate from $9 to $10.50, contained in Section 615 (Infra, Appendix B, p. 18.) a saving clause rendering any amendments made by the act inapplicable if "contrary to any treaty obligation of the United States."[3]

Domestic bottled underproof alcoholic beverages pay no tax as such. They reflect the tax paid on the overproof bulk spirits from which they are made.[4] The differentiation between the bulk spirits withdrawn from bond and the enumerated imported alcoholic beverages can be seen clearly in the case of cordials and liqueurs. These beverages cannot be produced in bond but only come into existence when sugar has been added in a rectifying plant out of the bonded area.[5]

This record shows that the Collector of Customs granted the enumerated alcoholic beverages the benefits of the reductions in customs duties by Article II (1)(a) of the General Agreement (R 99), but he ignored the promises favoring the same products with respect to other charges. He made no effort to ascertain what taxes were assessed on like domestic products to justify the addition of $1.50 under the Act of 1951 to the rate in force when the General Agreement became effective January 1, 1948 (R 206). In the case of imports scheduled under Section 804 of Schedule XX such as Hak Nor and Pac Nor, the record shows that there are no like

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3. Since the Court of Customs and Patent Appeals has rested its decision on *Bercut-Vandervoort & Co. v. United States*, 46 CCPA 29 which assumed (at p. 31) that the General Agreement created an international obligation within the intent of Section 615 of the Revenue Act of 1951, it appears unnecessary to discuss that point here except to cite *Altman v. United States*, 224 US 583.

4. A point stressed by the Court of Customs and Patent Appeals in *Bercut Vandervoort & Co. v. United States*, 46 CCPA 28, 33; CAD 691.

5. 26 CFR (1949) Section 190.202, 190.241 (In 1954 these numbers were changed to 26 CFR Section 235.440 and 235.486) and 27 CFR 5.21(f).

domestic products.[6] He also overlooked the fact that the enumeration in the General Agreement was to relatively specific products such as whiskey, cordials, liqueurs, and rum (p. 207). He applied the rate for "distilled spirits generally" set forth in Section 2800 (a)(1) of the Internal Revenue Code. It specifies an Internal Revenue tax "on all distilled spirits in bond or produced in or imported into the United States . . . on proof gallon or wine gallon when below proof." The tax is to be paid by the distiller when withdrawn from bond and by the importer when imported.

Counsel stipulated that all distilled spirits are originally produced overproof. (R 103-4). Until they are bottled in containers of one gallon or less, they can only be handled by licensed producers such as distillers, rectifiers, or bottlers; who, if need be, rectify the product and reduce it by the addition of water to the desired proof before bottling. (R 131, 147 27 CFR 1.2[illegible]1.22) The resultant "bottled or case goods" make their way into the wholesale trade through licensed retailers to the ultimate consumer.

By far the greater part of imported alcoholic beverages enter bottled underproof and proprietary brands of liqueurs, cordials, Scotch, and other alcoholic beverages can not be imported in bulk.[7] Being underproof as they entered, such imports, bottled, ready for the wholesale market, were assessed on the full wine-gallon basis even though they might be underproof.

Domestic spirits which are produced in American bonded warehouses can and are withdrawn overproof to avoid pay-

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6. R 14-15; *The Summary of Tariff Information*, 1948 (vol. 8, p. 44) states: "It is understood that there is no commercial production of wines and beverages covered by this section."

7. R 74, 118, 169-70, 183-5, R 119-20, 140, 150, 153, 169-70, 183-5, 192-4, 202, 215. United States Tariff Commission, Washington, D.C., *Trade Agreements Digests*, Volume VIII, pp. 2, 13.

ing an unnecessary tax on water. Except in case of a mistake, the universal practice is to reduce the proof to the extent desired in the rectifying or bottling area (R 132, 216, 223).[8] Distilled spirits cannot be bottled in bond at less than 100 proof for American use.[9] Domestic alcoholic beverages can only be bottled out of bond from spirits which have been tax-determined before being received on the bottling premises.[10]

Despite this evidence of the disparity in the treatment of imports and domestic products, the Customs Court overruled the protest on the authority of *Bercut-Vandervoort & Co. v. United States*, 46 CCPA 28 and the Court of Customs and Patent Appeals affirmed its decision. The Court of Customs and Patent Appeals brushed aside the importers' claims under the special promise Article II made in favor of the enumerated products. It deemed the floor stocks tax and the limitation of claims to the $1.50 increase by the Act of 1951 irrelevant. It cited three previous test cases (*United States v. Rathjen*, 31 CCPA 70, C.A.D. 250; *Vernon Distributing Co. v. United States*, 39 CCPA 205, C.A.D. 463; and *Bercut*) as "involving attempts to recover part of the internal revenue tax on imported underproof spirits" which have been decided against importers. The Court stressed "the consistent and uniform application" of the statute as one "of long duration, having been established in 1868." It told importers of the underproof bottled alcoholic beverages that they were "free to import spirits at proof or overproof."

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8. The process of rectification requires a tax of 30 cents a proof gallon. (Sections 2800(a)(5), 3254 Appendix B) but it is irrelevant here as petitioner's claim is limited to the increase of the $1.50 basic rate by the Act of 1951 which did not add to the rectification tax.

9. Internal Revenue Code of 1954, Section 5243 (b).

10. 26 CFR (1961) 201.426.

The Court agreed with the Customs court that *Bercut* controlled. It apparently believed that the mention in Article II(2)(a) of Article III reduced Article II to the status of Article III.

Petitioners filed a timely petition for rehearing. Without abandoning the claim on which they had previously focused their case, they called attention to *United States v. Domestic Fuel*, 21 CCPA (Cust.) 600, and stressed the fact that Article III (1) provided that an internal tax may not be so applied "as to afford protection to domestic production."

The petition for rehearing was denied November 5, 1961.

REASONS FOR GRANTING THE WRIT

The Court of Customs and Patent Appeals Has Rendered Article II of the General Agreement on Tariff and Trade an Empty Shell, and Its Holding Goes Contra to the Opinion Expressed by the Ninth Circuit Court of Appeals in Parrott and Co. v. United States, 156 F.2d 1943.

Petitioners brought this case under Article II of the General Agreement claiming that the like domestic product did not pay a "charge equivalent" to the increase assessed on the imported product.

The Court of Customs and Patent Appeals then proceeded to read the protections contained in Article II out of existence and rendered the entire Article mere surplus words.

> "Thus paragraph 2a of Article II plainly signifies that nothing in Article II, including the statement in paragraph 1b regarding the exemption of products from other duties or charges, it is to be interpreted as barring charges as specified in Article II (2a) imposed consistently with provisions of paragraph 2 of Article III.
>
> The issue here, then, resolves itself into whether the assessment of the $1.50 portion of the $10.50 Internal Revenue Tax, representing the increase made in the

1951 Act, on imported underproof spirits on a wine gallon basis was consistent with paragraph 2 of Article III of GATT. We think an affirmative answer is dictated by the *Bercut* decision." (Appendix, *infra*, pp. 9-10)

Thus, even though the imports are enumerated in Article II and that Article contains its own formula for justifying increases on scheduled products, the Court of Customs and Patent Appeals apparently holds that since Article II incorporates also the protection of Article III, the only requirement for assessing increases on all products are contained in the general code found in Article III.

No reason is given by the Court for emasculating Article II. If there are good reasons for so doing, the importers and exporters should be allowed to hear what they are and to answer them. *United States v. Stone and Downer*, 274 U.S. 225 holds that in customs litigation, an importer is entitled to be heard on the issues presented even where the same facts have previously been before the court.

The evidence is clear that the purpose of Article III was to strengthen rather than to weaken the safeguards afforded imports. Articles II and III form an integrated section, the very heart of the General Agreement. The insertion of a reference to Article III safeguarded the enumerated imports covered by Article II not only from the imposition of any new charges which were not "a charge equivalent" to that on a like domestic product, it also promised that no assessments should be so applied "as to afford protection to domestic production.

The State Department *Analysis*[11] of the General Agreement states that it sought to accord "national treatment

11. Publication 2983, Commercial Policy Series 109, November, 1947, p. 196.

on internal taxes and regulations". The *Analysis* noted that "tariff concessions can easily be nullified by internal excise taxes or other internal regulations *which operate to protect home industry* by laying greater burdens on the imported than on the domestic product" (emphasis added). To prevent such effects, the Article provided "that all internal commodity taxes which apply to imported products must apply equally to the like products."

The negotiators for the Contracting Parties were practical people concerned with eliminating or at least reducing domestic systems of taxation which have the *effect* of protecting domestic industry.[12] The underlying intent of a government in passing a domestic revenue statute is totally irrelevant.[13] Thus, the entire focus of Articles II and III is on the effect of the statute in actual operation.

The evidence is clear that the wine-gallon assessment of underproof alcoholic beverages operates to protect home industry. In the hearings before the Ways and Means Committee on the proposed Customs Simplification Act of 1951 (HR1535), the following agencies concerned with the General Agreement commented on Section 24 (repeal of the wine gallon method of assessment):

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12. This is illustrated by a case before the Contracting Parties Panel on Complaints involving the United Kingdom purchase tax system which was claimed to violate Article III. "The United Kingdom admitted that the purchase tax system, although not designed for the purpose of protection, had in practice developed some protective effects" and accordingly agreed to remove the discrimination on imports. United States Tariff Commission, *Operation of the Trade Agreements Program*, Fourth Report (July 1950-June 1951, page 68).

13. Contracting Parties, General Agreement on Tariffs and Trade, *Basic Instruments and Selected Documents*, Volume 2, First Supplement, page 49.

Department of State:[14] "The purpose of that, (Section 24) of course, is to have everybody treated in the same manner, *which they are not today*"[15] (emphasis added).

Tariff Commission Memorandum: "Section 24 undertakes to modify certain laws which *in practice operate to the disadvantage of imports* as compared with similar domestic goods . . . this type of protection of domestic products is inconsistent with Article III of GATT."[16]

Treasury Department: Section 24 in the bill which the Secretary of the Treasury had requested to introduce was headed: "*Repeal of discrimination against imports in certain internal revenue taxes.*"[17] The *Analysis*, which accompanied its introduction, said that Section 2800 (a)(1) "operates inequitably as between domestic and imported distilled spirits."[18]

Congress failed to enact Section 24 presumably because the Protocol of Provisional Application (Appendix B p. 20) freed it from any obligation to eliminate *existing* discrimnation, but it demonstrated its readiness by enacting a "saving clause" in the Act of 1951 (Section 615—Appendix B p. 18) to adhere to the promise the United States had assumed in the General Agreement (Appendix B pp. 18-19) not to increase charges in the scheduled imports except in the form of a "charge equivalent" to that on a like domestic product, so applied as not "to afford protection to domestic production."

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14. Mr. Winthrop G. Brown, Director of the Office of International Materials Policy Department of State.

15. Hearings before the Committee on Ways and Means, House of Representatives, Eighty-Second Congress, First Session on H.R. 1535, p. 651.

16. *Ibid.*, p. 242.

17. *Ibid.*, p. 28.

18. *Ibid.*, p. 29.

It does not suffice for the Court of Customs and Patent Appeals to conclude its opinion by stating "while the evidence establishes that importers often follow the practice of importing the spirits bottled in underproof condition, the fact still is, as recognized in *Bercut*, that they are free to import spirits at proof or overproof and have the commodity taxed accordingly." (See Appendix A, p. 11).

The importers of bottled and case goods (which predominate in the trade in alcoholic beverages) are told that in order to obtain the protections of the General Agreement, they must give up their traditional business, obtain separate licenses as distillers or bottlers and import bulk spirits to be rectified and bottle in this country. This method would in itself violate Article III (1) of the Agreement in that the statute as applied gives protection to the domestic bottling industry.

Nor can support for the Court's conclusion be found in the cases it cites. Except for one moot case they *support* rather than refute petitioners' claims:

> *United States v. Rathjen*, 31 CCPA (Cust. 70, CAD 51), held the Act of 1938 increasing internal revenue assessments was "absolutely irreconcilable" with the promise of the Cuban Trade Agreement of 1934 (the precursor to Article II(1)(b); 49 Stat. (part II) 3559), and that the subsequent statute prevailed because it made no exception in favor of prior agreements.
>
> *Vernon Distributing Co. v. U.S.*, 39 CCPA 205, CAD 463, became a moot case as far as issues here are concerned when the Customs Court found that the tax on domestic products exceeded that on imports, hence the Supplementary Cuban Trade Agreement 54 Stat. Part II 1997 did not apply.
>
> *Bercut Vandervoort and Co. v. United States*, 46 CCPA 28, CAD 691 (cited by the Court as dispositive of the present litigation) held (at page 33) that there

was no indirect discrimination under Article III (2) because the domestic underproof beverages paid *no tax*. They merely reflected the tax paid on *different merchandise* (the overproof spirits from which they were made)—a holding which certainly does not establish a tax paid by a like domestic product which will support a "charge equivalent" on an enumerated import.

The Court of Customs and Patent Appeals would have done well to pay attention to the case of *Parrott and Co. v. United States*, 156 F.2d. 1943, which concerned the assessment on a wine gallon basis of under proof rum from the Virgin Islands under Section 3350 of the Internal Revenue Code (Appendix B, p. 17). Its opinion is inconsistent with that of the Ninth Circuit concerning the interpretation of substantially the same language if one disregards the italicized words as having no weakening effect on Article II (2)(a):[19]

IRC 3350	General Agreement
A tax equal to the internal revenue tax imposed in the United States upon like articles of domestic manufacture.	a charge equivalent to an internal tax imposed *consistently with the provisions of paragraph 2 of Article III* in respect of the like domestic product . . .

The court held that the rum "was to be taxed as if produced in the United States;" since the rum was not required to be placed in a United States warehouse if produced in the United States it would be assessed under Section 2800(b)(2), based on its condition when it first came into existence; as a result, the tax had to be assessed on the proof gallon.[20]

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19. *Bercut* dismissed *Parrott* by stating: "Since the Court based its decision on the proposition that the rum was to be taxed as if produced in the United States that case is not controlling here." *China* does not even mention the *Parrott* decision.

20. The same result was reached by the Customs Court in *Select Wines Company v. United States*, 31 Cust. Ct. 3110, Abstract 57648.

Similarly here, the imported beverages are not required to be placed in bonded warehouses, and by stipulation (R-103-4) all came into existence overproof. Therefore any increased assessment after January 1, 1948 must be made on the proof gallon.

Uncorrected, the Decision of the Court of Customs and Patent Appeals May Imperil the United States Trade Agreement Program.

Analysis of the formula of Section 2800(a)(1) of the Internal Revenue Code shows the statute:

1) considers as one generic category distilled spirits and all dilutions and mixtures of the substance. As construed by the Court of Customs and Patent Appeals, contrary to the general rule, that category prevails over the more specific tariff classifications for cordials, liqueurs, whiskey and other alcoholic beverages enumerated *eo nomine*.

2) As applied, the tax is collected on imports at importation, and on domestic products when withdrawn from a domestic bonded area (established by local law)—without any inquiry as to whether the practical effects of the method of application is to provide protection to domestic production.

A country seeking to escape the burdens of the General Agreement would need only to follow the American formula sanctioned by the Customs Court of Patent Appeals. It could establish in its internal revenue code broad categories (covering all commodities animal, mineral and vegetable) and in practice provide any desired degree of protection for domestic products.

For example:

1) Fowl could be taxed by weight, the tax being applied on domestic products when removed from the bonded area (the hatchery) or foreign goods on im-

portation. The domestic industry could withdraw from bond a three ounce baby chick, while the importer would be forced to pay on a three pound fryer.

2) Metal products, like iron, could be taxed per cubic foot on iron (in pigs) and per linear foot on finished iron products (like barbed wire), the tax attaching when withdrawn from bond (in the foundry) or when imported.

3) Cotton in all forms, and articles containing cottons, could be taxed by weight when withdrawn from the bonded area (the seed fields) or when imported as cotton or cotton products.

American exporters, if discriminated against in such a manner, might complain that internal charges collected at importation more than offset the promised tariff concessions on fryers, barbed wire and cotton cloth, but they could be answered, according to the Court of Customs and Patent Appeals, that they were free to ship baby chicks, pig iron and cottonseed and have the commodity taxed accordingly.

The present case—from the point of view of foreign exporters—is no less absurd than the examples just discussed. If the decision is allowed to stand uncorrected American exporters cannot logically complain if other nations adopt such dubious devices.

That there is no need to reach such a conclusion as the Court of Customs and Patent Appeals has done in this case is demonstrated by an earlier decision of that court in *United States v. Domestic Fuel*, 21 C.C.P.A. (Cust.) 600, TD 47010.

That case involved the Treaty of 1815 with Great Britain (8 Stat. 228) which forbade higher duties on imports from Britain than were payable on like articles "of any foreign

country." The Revenue Act of 1932 section 601 (c)(5) there in question laid a tax on coal unless imported from countries with which the balance of trade with the United States had been favorable to the United States during the preceding calendar year.

The Attorney General argued that there was no discrimination because the provision applied equally to all nations.

The Court in that case did not allow the formula to nullify the treaty. The Court stated: (pp. 608-609)

> How can it be said that a provision according different treatments to importations of coal, based upon a condition incapable of being altered, "applies equally to all nations," or "secures equality of opportunity."

There the condition incapable of being altered was temporal; here it is geographical. Imported underproof bottled alcoholic beverages cannot be withdrawn from a United States bonded warehouse as can like domestic products. Like the coal in *Domestic Fuel* they do not share "equality of opportunity."

Petitioners respectfully submit that the national importance of the question with respect to American trade policies are such that this Court should grant certiorari. At present residents of the Virgin Islands may ship bottled underproof rum to the United States and pay no more than if it were produced here. Exporters from other contracting parties, who have granted concessions for that privilege, cannot.

The situation is one which this Court alone can settle. The Court of Customs and Patent Appeals' belief that the present method of assessment is non-discriminatory will only be changed when this Court so directs.

The question must then be settled what should be the proper assessment on imported underproof bottled alcoholic beverages. Analysis of Article II (2)(a) of the General Agreement discloses that it does not provide that a charge must be imposed. It merely states the basis for making a charge if the United States so desires. Justification for a new charge on imports must be provided by an internal tax on domestic products such as a tax levied on a like domestic article as in the case of the Virgin Islands (Section 7652, Appendix B, p. 17); on the spirits the import contains as in the case of Puerto Rico (Section 2800 (a)(4)(A) Appendix B, p. 14) or on the proof gallon of the increased assessment of $1.50 as in the case of the floor stocks tax under the Act of 1951 (Stat. 525 Sec. 451, Appendix B, pp. 17-18).

Petitioners respectfully submit that the present time is right for clarifying the situation. The Kennedy Round is now in session; Congress is revising the internal revenue code. Whatever action may be desirable can be taken quickly if this Court indicates the possibility of need for a correction of the present regretable situation by the grant of a writ.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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February 1965

Appendix A

United States Court of Customs and Patent Appeals

CHINA LIQUOR DISTRIBUTION CO., et al., *Appellants,* vs. THE UNITED STATES, *Appellee.*	October Term 1963 Customs Appeal No. 5116
HULSE IMPORT CO., et al., *Appellants,* vs. THE UNITED STATES, *Appellee.*	October Term 1963 Customs Appeal No. 5117

May 28, 1964

WORLEY, Chief Judge.

This appeal is from the judgment of the United States Customs Court, Third Division, C. D. 2338, overruling consolidated protests[1] by which the importers seek to recover a part of the internal revenue tax paid on distilled spirits at the time of their importation into the United States on

1. The present record represents a consolidation of *Hulse Import Company et al. v. United States*, protest numbers 225123-K, etc., which was tried in New York, New York, and *China Liquor Distributing Co. et al. v. United States*, protest numbers 58/18398, etc. which was tried in Los Angeles and San Francisco. As stated by the Customs Court, these cases "were consolidated together with all other pending cases involving internal revenue tax on distilled spirits filed by attorneys Lawrence & Tuttle, regardless of port of entry, except two, and were submitted for decision October 30, 1961."

and after January 1, 1951, the effective date of the Internal Revenue Act of 1951. All the distilled spirits imported, whether whiskey, brandy, cordials, gin or other alcoholic beverages, were taxed under the act at the rate of $10.50 per wine gallon.

Section 451 of the Internal Revenue Act of 1951 (65 Stat. 524) amended Section 2800 (a) (1) of the Internal Revenue Code (IRC) of 1939, as amended, by increasing the tax assessment on distilled spirits in bond or produced in or imported into the United States from $9 to $10.50 on each proof gallon or wine gallon when under proof.[2] Appellants urge that the spirits involved here, all of which were imported below proof, should not have been assessed at the rate of $10.50 per wine gallon. They do not dispute that the importations are subject to assessment at $9 on a wine gallon basis under the internal revenue laws in force when the General Agreement on Tariffs and Trade (GATT) became effective on January 1, 1948, but question assessment of the additional $1.50 resulting from the increase from $9 to $10.50 provided for by the Internal Revenue Act of 1951, Appellants take the position that there is a conflict between GATT and Section 2800 (a) (1) of the IRC of 1939 as amended by Section 451 of the act of 1951 for the reason that the provisions of GATT froze the tax at $9 per wine gallon for spirits imported under proof.

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2. A standard United States gallon contains 231 cubic inches 26 CFR (1949 ed.) section 186.148. A standard United States gallon containing 50 percent alcohol by volume and 50 percent water by volume would be 100 proof spirits, which gallon of 100 proof spirits is known as a proof gallon. 26 CFR (1949 ed.) section 186.149. The terms "over proof" or "above proof" refer to spirits containing more than 50 percent alcohol by volume, whereas the terms "under proof gallon" or "wine gallon" are used to refer to a standard United States gallon, containing less than 50 percent alcohol by volume.

The pertinent provisions of GATT (T.D. 51802), as amended (T.D. 52167), read:

Article II

1. * * * (b) The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided for therein. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date.

* * * * * * *

2. Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product.

(a) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part:

* * * * * * *

Article III

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring mixture, processing or use of products in specified amounts of proportions, should not be applied to

imported or domestic products so as to afford protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

* * * * * * *

The Internal Revenue Act of 1951, in pertinence, provides:

Sec. 451. INCREASE IN TAX ON DISTILLED SPIRITS FROM $9 TO $10.50 PER GALLON.

(a) Distilled Spirits Generally.—Section 2800 (a) (1) is hereby amended by striking out $6 and inserting in lieu thereof $10.50 * * * [The tax of $6 had been increased to $9 by a previous amendment.]

* * * * * * *

(c) Floor Stocks Tax—Section 2800 is amended by inserting at the end thereof the following new subsections:

(1) 1951 Floor Stocks Tax—

(1) Tax—Upon all distilled spirits upon which the internal revenue tax imposed by law has been paid, and which on the effective date of section 451(a) of the Revenue Act of 1951, are held and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor stocks tax of $1.50 on each proof-gallon, and a proportionate tax at a like rate on all fractional parts of such proof-gallon.

Sec. 615. TREATY OBLIGATIONS

No amendment made by this Act shall apply in any case where its application would be contrary to any treaty obligation of the United States.

The foregoing provisions and their application to imported under proof distilled spirits are not unfamiliar to this court. Three previous test cases[3] involving attempts to recover part of the internal revenue tax on imported under proof distilled spirits have been decided against importers. *United States v. Rathjen*, 31 CCPA 70, C.A.D. 250; *Vernon Distributing Co. v. United States*, 39 CCPA 205, C.A.D. 463; and *Bercut-Vandervoort & Co., Inc. v. United States*, 46 CCPA 28, C.A.D. 691, certiorari denied, 359 U.S. 953. The Customs Court held that the issue decided in the latter case is not substantially different from the issue raised in the cases presently on appeal and that "the principal laid down in the *Bercut* case is controlling here."

In *Bercut* the merchandise was 90 proof London dry gin imported from Holland and entered for consumption in 1952. It was assessed by the Collector of Customs at the rate of $10.50 per wine gallon under Section 2800 (a) (1) of the Internal Revenue Code of 1939, as amended. The evidence showed that it was the practice of domestic producers to withdraw the distilled spirits from bond while over proof, to pay the tax thereon on the proof gallon basis[4] and thereafter further dilute the spirits to approximately

3. The Customs Court stated that some of the involved cases were suspended in that court under the three test cases.

4. The domestic 90 proof distilled spirits, when taxes on the proof gallon basis prior to reduction (dilution) were alleged to have been indirectly assessed at 90 per cent of $10.50, or $9.45 for each wine gallon after reduction instead of $10.50 as assessed by the collector upon each wine gallon of imported 90 proof distilled spirits.

90 proof for bottling and marketing. In protesting the assessment, the importer claimed that the wine gallon assessment on the under proof imports exceeded the assessment on "like" domestic products in contravention of Articles II and III of GATT.

This court took the view in *Bercut* that the internal revenue statute provides for two classifications of distilled spirits, that is, distilled spirits at proof or above, which are taxable on the proof gallon, and distilled spirits below proof, which are taxable on a wine gallon basis. It was held that "the consistent and uniform application of the statute to domestic distilled spirits and imported distilled spirits does not contravene the provisions of GATT."

Appellants describe, at some length, the basis of their present protests:

> Appellants claim a breach of contract—of the obligations the United States assumed in GATT. They do not charge discrimination in violation of the *general code* of fair trading practices embodied in Article III —a code which covered all products of any contracting party. They merely allege that the collector failed to provide the imports listed in Schedule XX the benefits promised by Article II (1b). That caluse exempts them from any IRC charges in excess of those in force January 1, 1948—unless the increased IRC charges fall within *the exception* allowed by Article II (2a).
>
> Article II (2a) permits the imposition on *the scheduled imports* of
>
> > a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part.

It is important to note, however, that new or increased charges on the scheduled imports in excess of that applied January 1, 1948 are not to be measured by *the IRC formula* which charges imports "on the proof gallon, or wine gallon when below proof." *The exception* (In Article II (2a)) specifies its own formula—what tax would a like domestic product (or an article from which the import is made) pay when produced in the United States.

They further state:

No issue arose till the Revenue Act of 1951 increased the basic IRC tax on distilled spirits by $1.50 from $9 to $10.50 and assessed a "floor stocks tax" of $1.50 a proof gallon on all domestic underproof bottled beverages and other distilled spirits held for sale on the effective date of the new Revenue Act. Despite the fact that the Act itself provided that no amendment it made should apply where its application would be contrary to any treaty obligation of the United States, the Collector did not ascertain how domestic products like the *scheduled imports* were taxed. He continued to assess them in accordance with the pre-GATT formula, "on each proof gallon or wine gallon when below proof."

Appellants claim that if *the scheduled imports* of bottled underproof alcoholic beverages had been produced in the United States, they would have—must have—paid on a proof gallon basis.

* * * * * * *

A reversal of the decision below does not mean that appellant's entries will escape any IRC assessments. This Court may find that they should be assessed a compound rate—the IRC charge of January 1, 1948 on a wine-gallon basis and the increased charge under the Act of 1951 and $1.50 on a proof gallon basis. It may determine that they should be assessed on the basis of the article from which they were made and pay the entire charge on a proof gallon basis in respect

of the over proof spirits from which they were made. In any event they remain subject at least to the IRC charge in force January 1, 1948—before *the special promise* in Article II (1b) exempted them from any further exactions.

While appellants apparently recognize that this court considered the provisions of Article II (2a) of GATT in *Bercut* they urge it did so in fortifying its conclusions with reference to the general code provisions of Article III and "did not consider Article II (2a) in its historical and logical role as an exception to the special promise in Article II (1b)." They further state that the "*Bercut* decision did not even refer to Article II (1b)."

We are in full agreement with the Customs Court that the issue decided in *Bercut* is not substantially different from that here. The statutory and trade agreements applicable here are identical to those applicable to the imported merchandise in that case. The ruling there was that the assessment of distilled spirits imported under proof at the rate of $10.50 per wine gallon under Section 2800 (a) (1) of the Internal Revenue Act of 1951 did not contravene the provisions of GATT.

Here appellants are merely advancing a somewhat different argument than that relied on in the previous case. Thus they attempt to distinguish from *Bercut*, where the challenge was directed to the entire $10.50 assessment on the underproof imported spirits on a wine gallon basis, on the ground that they are now conceding that $9 of the tax, the amount applicable under the Internal Revenue Code at the time GATT became effective, was properly assessed on the under proof imported spirits on a wine gallon basis and are urging that only the additional $1.50 portion of the assessment, resulting from the increase made after GATT

by the 1951 Act, was improper. They state that they rely on an alleged prohibition of a different portion of GATT than did the appellants in *Bercut*, that portion being Article II (1b).

Appellants also make frequent reference in their brief to the "Floor Stocks Tax" which was imposed by the Internal Revenue Act of 1951 along with the increase of the tax of Section 2800 (a) (1). They note that tax of $1.50 was assessed on a proof gallon basis. The appeal can be clarified at this time by pointing out that the "Floor Stocks Tax"[5] obviously is not involved in the present protests and that its discussion, as noted by the Customs Court, is irrelevant to the issues here.

Appellants' arguments relative to Article II (1b) of GATT do not reveal any significant distinction over *Bercut*. That portion of GATT states that importations referred to therein shall be "exempt from all other duties or charges * * * in excess of those imposed * * * by legislation in force in the importing territory on the effective date of GATT, January 1, 1948. However, as pointed out by the Customs Court, Article II (1b) is modified by Article II (2a) which specifies that "Nothing in this Article" shall prevent imposing on the importation of any product "a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product * * *." Thus paragraph 2a of Article II plainly signifies that nothing in Article II, including the statement in paragraph 1b regarding the exemption of products from

5. Reference to Sec. 451 of the 1951 Act quoted hereinabove reveals that the "Floor Stocks Tax" was directed to "all distilled spirits on which the internal revenue tax had been paid" and were held for sale or use" on the effective date of the Act. The record does not show that the imported spirits involved in the present protests were subjected to that tax.

other duties or charges, it is to be interpreted as barring charges as specified in Article II (2a) imposed consistently with the provisions of paragraph 2 of Article III.

The issue here, then, resolves itself into whether the assessment of the $1.50 portion of the $10.50 Internal Revenue Tax, representing the increase made in the 1951 Act, on imported underproof spirits on a wine gallon basis was consistent with paragraph 2 of Article III of GATT. We think an affirmative answer is dictated by the *Bercut* decision.

That case determined that the assessment of the Internal Revenue Tax of $10.50 on imported under proof spirits on a wine gallon basis under Section 2800 (a) (1) was consistent with paragraph 2 of Article III of GATT. In reaching that conclusion, this court noted that the assessment of internal revenue tax on distilled spirits on each proof gallon or, when under proof, on each wine gallon is of long duration, having been established in 1868 for purely domestic purposes. It concluded that:

> • • • we are of the opinion that since the statute has classified distilled spirits in two categories (1) distilled spirits above proof and (2) distilled spirits below proof and established a rate of tax for each such classification, the consistent and uniform application of the statute to domestic distilled spirits and imported distilled spirits does not contravene the provisions of GATT; and that the record herein reveals nothing which would warrant a different procedure than that adopted by the collector.

We find the reasoning of *Bercut* with respect to the full $10.50 tax rate to be equally applicable to the $1.50 increase made in 1951. The fact that the increase was made after GATT became effective is not significant since paragraph 2

of Article II allows the imposing of a charge of the type specified in Article II (2a) "at any time."

Moreover, nothing is seen in the new evidence of record here to warrant a different result from that reached in *Bercut*. While the evidence establishes that importers often follow the practice of importing the spirits bottled in under proof condition, the fact still is, as recognized in *Bercut*, that they are free to import spirits at proof or over proof and have the commodity taxed accordingly.

The judgment is *affirmed*.

AFFIRMED

SMITH, J., concurs in th result.

MARTIN, J., sat but did not participate in decision.

I, George E. Hutchinson, Clerk of the United States Court of Customs and Patent Appeals, do hereby certify that the above is a true and correct copy of the order made in the above-entitled case on the 28th day of May, A.D. 1964.

Witness my hand and the seal of this court this 5th day of November, A.D. 1964.

/s/ GEORGE E. HUTCHINSON
Clerk.

UNITED STATES COURT OF CUSTOMS AND PATENT APPEALS

At a session of said court continued and held at the city of Washington, pursuant to adjournment, on this 28th day of May A.D. 1964.

Present: Chief Judge Worley, Judge Rich, Judge Martin, Judge Smith and Judge Almond.

China Liquor Distributing Co., et al.,
Appellant,
v. Customs Appeal No. 5116
The United States
Appellee.

Hulse Import Co., et al.,
Appellant,
v. Customs Appeal No. 5117
The United States,
Appellee.

Said appeals having heretofore been brought on to be heard before the court and due consideration thereon having been had, it is:

ORDERED that the judgment of the United States Customs Court be, and the same is hereby, affirmed.

UNITED STATES COURT OF CUSTOMS AND PATENT APPEALS

Thursday, November 5, 1964

Present: Chief Judge Worley, Judge Rich, Judge Martin, Judge Smith, Judge Almond and Judge Kirkpatrick*, United States Senior Judge for the Eastern District of Pennsylvania.

* * * * * * *

PETITIONS FOR REHEARING DENIED*

Customs Appeal

No. 5116-5117. CHINA LIQUOR DISTRIBUTING CO., ET AL. v. THE UNITED STATES; HULSE IMPORT CO., ET AL. v. THE UNITED STATES.

Judge Martin took no part in the consideration of or decision on this petition.

* * * * * * *

*Kirkpatrick, Judge participated, in place of Worley, Chief Judge in each of the appeals in which opinions have been filed, but took no part in the consideration of or decision on the petitions for rehearing or these dismissals.

Appendix B

1. The Revenue Acts

The section numbers given here are those of the Internal Revenue Code (26 USC (1946 ed.)) in force prior to the Act of 1951. Footnotes indicate the new numbers used in the Internal Revenue Code of 1954.

A. The Internal Revenue Code in Effect January 1, 1948.

Sec. 2800.[1] TAX.

(a) Rate.--

(1) Distilled Spirits Generally.—There shall be levied and collected on all distilled spirits in bond or produced in or imported into the United States an internal revenue tax at the rate of $6[2] on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller or importer when withdrawn from bond.

* * *

(4) Alcoholic Compounds from Puerto Rico and Virgin Islands.—

> (A) Puerto Rico.—Except as provided in section 3123, upon bay rum, or any article containing alcohol, brought from Puerto Rico into the United States for consumption or sale there shall be paid a tax on the spirits contained therein at the rate imposed on distilled spirits produced in the United States, to be collected at the port of entry by the collector of internal revenue of the district in which the port is located. The Commissioner, with the approval of the Secretary, is authorized to make such rules and regulations as may be necessary to carry this paragraph into effect.

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1. Now Sec. 5001.

2. In 1944, 58 Stat 61 increased the rate to $9 per gallon as a war measure and was made permanent by 61 Stat 12.

(B) Virgin Islands.—For provisions relating to tax on alcoholic compounds from Virgin Islands see section 3350.[3]

* * *

(5) Rectified Spirits and Wines.—In addition to the tax imposed by this chapter on distilled spirits and wines, there shall be levied, assessed, collected, and paid a tax of 30 cents on each proof gallon and a proportionate tax at a like rate on all fractional parts of such proof gallon on all distilled spirits or wines rectified, purified, or refined in such manner, and on all mixtures produced in such manner, that the person so rectifying, purifying, refining, or mixing the same is a rectifier within the meaning of section 3254 (g)[4]: *Provided,*[5] That this tax shall not apply to gin produced by the redistillation of a pure spirit over juniper berries and other aromatics.

* * *

(e)[6] Time of Attachment.—The tax shall attach to distilled spirits, spirits, alcohol or alcohol spirit, within the meaning of subsection (b) of section 2809,[7] as soon as this substance is in existence as such, whether it be subsequently separated as pure or impure spirit, or be immediately, or at any subsequent time, transferred into any other substance, either in the process or original production or by any subsequent process.

* * *

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3. Now Sec. 7652.
4. Now Sec. 5021(a).
5. Now Sec. 5082.
6. The proviso was eliminated in the Code of 1954.
7. Now Sec. 5001(b).

Sec. 2809.[8] DEFINITIONS

* * *

(b) Distilled Spirits.—

(1) General Definition.—Distilled spirits, spirits, alcohol, and alcoholic spirits, within the true intent and meaning of this chapter, is that substance known as ethyl alcohol, hydrated oxide of ethyl, or spirit of wine, which is commonly produced by the fermentation of grain, starch, molasses, or sugar, including all dilutions and mixtures of this substance.

* * *

Sec. 3254.[9] DEFINITIONS.

* * *

(g) Rectifier.—Every person who rectifies, purifies, or refines distilled spirits or wines by any process other than by original and continuous distillation from mash, wort, or wash, through continuous closed vessels and pipes, until the manufacture thereof is complete, and every wholesale or retail liquor dealer who has in his possession any still or leach tub, or who keeps any other apparatus for the purpose of refining in any manner distilled spirits, and every person who, without rectifying, purifying, or refining distilled spirits, shall, by mixing such spirits, wine, or other liquor with any material, manufacture any spurious, imitation, or compound liquors for sale, under the name of whisky, brandy, gin, rum, wine, spirits, cordials, or wine bitters, or any other name, shall be regarded as a rectifier, and as being engaged in the business of rectifying: *Provided*,[10] That nothing in this subsection or section 3250 (f) (1) shall be held to prohibit the purifying or refining of spirits in the course of original and continuous distillation

8. Now Sec. 5002.

9. Now Sec. 5082.

10. The proviso was eliminated in the Code of 1954.

through any material which will not remain incorporated with such spirits when the manufacture thereof is complete.

* * *

Sec. 3350.[11] SHIPMENTS TO THE UNITED STATES. (a) Taxes Imposed in the United States.—Except as provided in section 3123, there shall be levied, collected, and paid in the United States, upon articles coming into the United States from the Virgin Islands, a tax equal to the internal revenue tax imposed in the United States upon like articles of domestic manufacture.

B. The 1951 Amendment to the Code (65 Stat. 524-525).

Sec. 451. INCREASE IN TAX ON DISTILLED SPIRITS FROM $9 TO $10.50 PER GALLON.

(a) Distilled Spirits Generally.—Section 2800(a)(1) is hereby amended by striking out "$6" (sic—see below[12]) and inserting in lieu thereof "$10.50", and by inserting after the first sentence the following new sentence: "On and after April 1, 1954, the rate of tax imposed by this paragraph shall be $9 in lieu of $10.50"

* * * * * * *

(c) Floor Stocks Tax—Section 2800 is amended by inserting at the end thereof the following new subsection:

(1) 1951 Floor Stocks Tax—

(1) Tax—Upon all distilled spirits upon which the internal revenue tax imposed by law has been paid, and which on the effective date of section 451(a) of the

11. Now Sec. 7652(b).

12. In 1944, 58 Stat 61 increased the rate to $9.00 per gallon as a war measure and was made permanent by 61 Stat 12.

Revenue Act of 1951, are held or intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor stocks tax of $1.50 on each proof-gallon, and a proportionate tax at a like rate on all fractional parts of such proof-gallon."

Sec. 615. TREATY OBLIGATIONS

No amendment made by this Act shall apply in any case where its application would be contrary to any treaty obligation of the United States.

The Internal Revenue Code of 1954 has substantially the same provision in Section 7852(d) (68a Stat. 923).

No provision of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title.

2. General Agreement on Tariffs and Trade.

The pertinent provisions (61 Stat. (Part V) A, at A14-15, A18 (as amended by 62 Stat. (Part III) 3680) read as follows at the time of the instant importations:

Article II

1. ** (b) The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those

set forth and provided for herein. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date.

* * * * * * *

2. Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product

(a) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part;

* * * * * * *

Article III

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantative regulations requiring mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any

kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

* * * * * * *

Schedule XX—Part 1 (61 Stat. (Part V) A 1249)

Tariff Act of 1930 paragraph	Description of Products	Rate of Duty
802	Slivowitz and all other brandy, gin, cordials, liqueurs, kirschwasser, and ratafia.	$1.25 per proof gallon
802	Whiskey	$1.50 per proof gallon
802	Bitters of all kinds containing spirits *Provided,* That whenever imported bitters are subject to a federal tax on the alcoholic content measured in whole or in part by the rate of the internal Federal tax imposed in respect of the alcohol contained in the like domestic products, such bitters shall be dutiable at	$2.50 per proof gallon $1.25 per proof gallon
802	Rum	$2.25 per proof gallon
804	Still wines (except still wines produced from grapes), including ginger wine or ginger cordial, and similar beverages not specially provided for (not including rice wine or sake)	62½¢ per gallon

Protocol of Provisional Application of the General Agreement on Tariffs and Trade (61 Stat. (Part VI) A 2051)

1. The governments of the * * * KINGDOM OF THE NETHERLANDS * * *, the UNITED KINGDOM OF GREAT

BRITAIN * * *, and the UNITED STATES OF AMERICA, undertake, * * * to apply provisionally on and after January 1, 1948:

* * * * * * *

(b) Part II of that Agreement to the fullest extent not inconsistent with legislation.

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 873

CHINA LIQUOR DISTRIBUTING CO., ET AL., HUISE IMPORT CO., ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CUSTOMS AND PATENT APPEALS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Customs Court is reported at 48 Cust. Ct. 217, rehearing denied, 49 Cust. Ct. 208. The opinion of the United States Court of Customs and Patent Appeals (Pet. App. 1–11) is not yet reported.

JURISDICTION

The judgment of the Court of Customs and Patent Appeals was entered on May 28, 1964 (Pet. App. 11–12). A petition for rehearing was denied on November 5, 1964 (Pet. App. 12–13). The petition for a writ of certiorari was filed on February 3, 1965. The

767–511–65

jurisdiction of this Court is invoked under 28 U.S.C. 1256.

QUESTION PRESENTED

Whether the General Agreement on Tariffs and Trade (GATT) prohibits an increase in the internal revenue tax on distilled spirits from being applied to imported spirits of less than 100 proof on the basis of volume.

STATUTES INVOLVED

Section 2800(a)(1) of the Internal Revenue Code of 1939, as amended, provides:

> There shall be levied and collected on all distilled spirits in bond or produced in or imported into the United States an internal revenue tax at the rate of $10.50 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller or importer when withdrawn from bond. * * *

Article II of the General Agreement on Tariffs and Trade, 61 Stat. (Part V) A14, provides in pertinent part:

> 1. * * * (b) The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided for therein. Such products shall also be exempt from all

other duties or charges of any kind imposed on or in connection with importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date.

* * * * *

2. Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product

(a) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 1 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part;

* * * * *

Article III of the General Agreement on Tariffs and Trade, 61 Stat. (Part V) A18, as amended, 62 Stat. (Part III) 3679, provides in pertinent part:

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or

> other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

STATEMENT

Petitioners imported whiskey, cordials, rum and other distilled spirits which were bottled "below proof," *i.e.*, at less than 100 proof (100 proof spirits contain 50% alcohol by volume). The Collector of Customs assessed an internal revenue tax of $10.50 per wine gallon (the standard United States gallon) in accordance with Section 2800(a)(1) of the Internal Revenue Code of 1939, as amended, 56 Stat. 970–971 (now Section 5001(a) of the Internal Revenue Code of 1954, as amended) which provides for such a tax "*on each* proof gallon or *wine gallon when below proof*" (emphasis added). Petitioners filed a protest in the Customs Court addressed to that part of the assessed tax resulting from the enactment of Section 451 of the Internal Revenue Act of 1951 (65 Stat. 524), which had increased the tax from $9.00 to $10.50. Petitioners claimed that under the General Agreement on Tariffs and Trade (GATT) the 1951 addition to the tax may not be assessed on imported spirits which are below proof on the basis of their volume, but must be assessed in proportion to alcoholic content.

The Customs Court overruled the protest, holding that "the principle laid down in the *Bercut* case [*Bercut-Vandervoort & Co.* v. *United States*, 46

C.C.P.A. 28, certiorari denied, 359 U.S. 953] is controlling here" (48 Cust. Ct. at 220). The Court of Customs and Patent Appeals affirmed on the same basis (Pet. App. 10).

1. THE INTERNAL REVENUE CODE AND THE GENERAL AGREEMENT ON TARIFFS AND TRADE

Section 2800(a)(1) of the Internal Revenue Code of 1939, as amended, imposes a flat tax of $10.50 per gallon upon spirits of 100 proof or less, with a proportionate addition for spirits with proof above 100. Thus one gallon of either 50 or 100 proof spirits is subject to the same tax of $10.50, while one gallon of 150 proof spirits is subject to a tax of $15.75. Payment of the tax is due when the spirits are produced or, in the case of imported spirits, upon importation. If the spirits are placed in a bonded warehouse immediately upon production or importation, however, the tax may be postponed until the spirits are withdrawn from bond.

This plan of taxation, involving a flat rate for spirits of 100 proof or less, which are taxed per "*wine* gallon," and a graduated rate for overproof spirits, which are taxed per "*proof* gallon," has been a part of internal liquor taxation for almost a century. See Act of July 20, 1868, 15 Stat. 125. The time for payment of the tax also long antedates the General Agreement on Tariffs and Trade. See Section 600(a) of the Revenue Act of 1918, 40 Stat. 1057, 1105. Only the amount of the tax has been varied by intervening tax acts.

Article II, paragraph 1(b) of the General Agreement on Tariffs and Trade, *supra*, pp. 2–3, which be-

came effective in 1948, provides that products imported into the United States from other contracting nations shall be "exempt from all other duties or charges of any kind imposed on or in connection with importation in excess of those imposed on the date of this Agreement * * *." Article II, paragraph 2, however, provides as an exception that "Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product * * * a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 1 of Article III in respect of the like domestic product * * *." Article III, paragraph 2 provides that imports into the United States from other contracting nations "shall not be subject, directly or indirectly, to internal taxes * * * in excess of those applied, directly or indirectly, to like domestic products." Finally, Article III, paragraph 1, provides that "internal taxes * * * should not be applied to imported or domestic products so as to afford protection to domestic production."

2. *THE* BERCUT *DECISION*

In *Bercut-Vandervoort & Co.* v. *United States, supra,* the Court of Customs and Patent Appeals held that the tax increase imposed by Section 451 of the Internal Revenue Act of 1951 did not conflict with either Article III, paragraph 1 or Article III, paragraph 2 of GATT. The basis for the Court's holding was the fact that the division of all distilled spirits, whether imported or domestic, into two categories—100 proof or over, to be taxed per proof gallon, and below 100 proof, to be taxed per wine gallon—has

been in effect since 1868. "Each classification creates a separate and distinct commodity, and the tax is levied on each one" (46 C.C.P.A. at 32). In this connection, the court pointed out (*id.* at 33):

> The domestic producer controls the composition of his products in the same fashion that the importer can control the composition of his product when he imports it. He can import proof or over proof spirits and have the commodity taxed accordingly. The provisions of the act are applied uniformly to the merchandise of the domestic producer and importer alike.

This Court denied certiorari.

3. THIS LITIGATION

In this case, petitioners urge that when the 1951 tax is assessed per wine gallon upon imported, below proof spirits, it is not "a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 1 of Article III in respect of the like domestic product * * *." Their argument is based on the assertion that domestic spirits produced in American bonded warehouses can be withdrawn from bond at more than 100 proof and later diluted, thus paying a lower tax per gallon of consumable spirits than is paid upon spirits which are imported in diluted condition.[1]

ARGUMENT

Petitioners are seeking to relitigate issues which were resolved adversely to the importers of distilled

[1] This ignores the rectification tax which domestic spirits must pay (Pet. 7, n. 8).

spirits in *Bercut-Vandervoort & Co.* v. *United States, supra.* The courts below were clearly correct in holding, in both *Bercut* and this case, that the provisions of the Internal Revenue Code relating to the taxation of distilled spirits do not conflict with the requirement of GATT that internal taxes be applied similarly to like products, whether imported or domestically produced. That holding, moreover, is consistent with prior decisions construing similar provisions in other international trade agreements.[2] Review by this Court is therefore not warranted.

The only distinction among distilled spirits which is drawn by Section 2800(a)(1) is based not upon the place of origin, but upon alcoholic content. Distilled spirits of less than 100 proof are taxed on a straight volume basis, while the tax upon distilled spirits of 100 proof or more is proportionately higher according to the alcoholic content of the spirits. GATT does not require that below proof imported spirits be taxed on the basis of alcoholic content merely because spirits of more than 100 proof are so taxed. The Agreement prohibits unequal taxation on "like" imported and domestic products. The distinction, inherent in internal revenue statutes for

[2] *United States* v. *Rathjen Bros.*, 31 C.C.P.A. (Customs) 70 (1943); *Vernon Distributing Co.* v. *United States*, 39 C.C.P.A. (Customs) 205 (1951). Contrary to petitioner's claim (Pet. 13), *Parrott & Co.* v. *United States*, 156 F. 2d 943 (C.A. 9), is not relevant. There the sole issue was *when* the tax attached to rum produced in the Virgin Islands: the Court held that the tax was to be imposed while the rum was in the Virgin Islands. Here, there is no suggestion that the tax might be imposed before the distilled spirits reach the United States.

almost a century, between below proof and over proof spirits serves to describe unlike products.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 873

CHINA LIQUOR DISTRIBUTING CO., et al.
HULSE IMPORT CO., et al.,
Petitioners,

vs.

THE UNITED STATES,
Respondent.

Reply of Petitioner to Brief for the United States in Opposition

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Reply of Petitioner to Brief for the United States in Opposition

Petitioners respectfully request the Court to consider this reply brief to the Brief of the United States in Opposition to the grant of a writ of certiorari.

The Brief in Opposition states (p. 8) that the taxation of distilled spirits does "not conflict with the requirements that internal taxes be applied similarly to like products, whether imported or domestically produced." An item in *The Times* of London (June 25, 1964, p. 8, col 5) discloses that the British Government disagrees.

According to a Reuter's source in Geneva the British protested (in the Kennedy Round sub-committee on non-tariff barriers) the discriminatory American import practice in taxing Scotch whisky. The complaint "emphasized

that the 14 per cent of water added to each bottle was taxed as though it were pure whisky"—a system used "only against imported bottled whisky."

The British complaints suggest two questions pertinent to this Petition:

I. Does the Brief in Opposition measure up to the needs of the occasion?

II. Can the grant of a Writ of Certiorari help prevent another "chicken war" from developing?

I.

THE BRIEF IN OPPOSITION

The Brief is skillfully written; it reads smoothly. But it carefully avoids the important issues and commits a number of errors.

It Does Not Concern the Question Petitioners Raised.

The protests are limited to *Bottled underproof beverages enumerated in Schedule XX* of the General Agreement. Article II promises them exemption from any increased charges after January 1, 1948 "unless the imposition (1) is a "charge equivalent" to a tax upon the like domestic product, or upon an article from which the import was made, and (2) is applied in accordance with Article III so as not to afford protection to domestic production" (Pet., p. 2). This restriction renders virtually all the Brief in Opposition irrelevant to the questions presented by Petitioners.

The Brief in Opposition (pp. 6, 8 and 9) stresses the fact that since 1868 the formula of Section 28[illegible] (a)(1) has divided "distilled spirits" into two categories, below proof and overproof. It neglects to consider the changes which have occurred since the days of General Grant.

It Does Not Concern the Imports Protested.

Nowhere does the Brief note that now alcoholic beverages are divided commercially into two categories—the bulk spirits which can only be handled by producers and the bottled or case goods of the wholesale and retail trade which are the subject of these protests. (Pet., p. 6).

The Brief is referring to bulk spirits from which the bottled goods are produced when it quotes (p. 7) from *Bercut-Vanderroort & Co. v. United States* (46 CCPA (Customs) 28) that domestic producers and importers may control the composition of their products and pay tax under Section 2800(a)(1) accordingly.

There is no way domestic alcoholic beverages—made from overproof spirits which were bottled underproof—can pay tax on a wine gallon basis. They cannot be bottled in bond at less than proof. Domestic underproof spirits bottled out of bond must be made from overproof spirits to be like the protested imports (Pet., pp. 6-7). As *Bercut* itself said (p. 33) domestic underproof bottled spirits pay no tax at all; they merely reflect the tax on the overproof spirits from which they are made.

It Badly Misconstrues the Parrott Case.

Counsel disagree about the pertinence of the decision of the Ninth Circuit Court of Appeals in *Parrott and Co. v. United States* (156 F.2d 943). Counsel for Petitioners submit that it provides guidance as to how to interpret the words "a charge equivalent" in Article II (2)(a). Counsel for the government deny the relevancy of *Parrott*. The Brief states categorically (p. 8, n. 2) "There the sole issue was *when* the tax attached to the rum produced in the Virgin Islands: the Court held that the tax was to be imposed while the rum was in the Virgin Islands."

Counsel for the Petitioners will let the language of *Parrott* speak for itself (pp. 947-48) adding only emphasis:

> Distilled Spirits Tax. This collected tax, of part of which the complaint seeks a refund, was upon rum alleged to be distilled at more than 100 proof, and later, by the addition of water, was reduced to less than 100 proof, at which lesser proof it was bottled and imported. It was taxed as if it had been distilled at less than 100 proof.
>
> *This is the method of taxing if the rum had been imported from any place other than the Virgin Islands, with which we had no tariff treaty.* Section 2800(a)(1) providing that the tax on imported rum of $2.25 on each proof gallon or wine gallon when below proof is "to be paid by the . . . importer when withdrawn from bond." In our opinion it is error to have taxed the Virgin Islands rum as if it were an importation and that *the cases cited respecting ordinary imported distilled liquors have no application.* Section 2800(a)(4)(B) states that the tax is controlled by Section 3350, supra, specifically providing for rum "coming into the United States from the Virgin Islands, a tax equal to the internal revenue tax imposed in the United States upon like articles of domestic manufacture."
>
> * * * * * * *
>
> The rums here in issue being distilled in the Virgin Islands were without any requirement that they remain in a federal bonded area until the tax is paid. Congress well knew this when it provided in Section 3350 that *the rum was to be taxed as if produced in the United States.* It must have intended that the tax would be *the equivalent of* that provided by Section 2800(b)(2) for distilled liquors not deposited in bonded warehouses, that is the amount which would have attached as soon as the distillation was complete—here because above proof at the proof gallon rate.

II.

THE ADVANTAGE OF A WRIT OF CERTIORARI

British resentment—probably shared by Canada, the next largest whisky exporter—differentiates the question here from so many customs appeals which concern some minor rule of construction of interest primarily to the immediate litigants. It is important to pay attention to the grivances of a nation's two staunchest friends.

Grounds for a British Sense of Grievance.

When the United Kingdom purchase tax system was claimed to violate Article III, "The United Kingdom admitted that the purchase tax system, although not designed for the purpose of protection, had in practice developed some protective effects" and accordingly agreed to remove the discrimination on imports (Pet., p. 10, n. 12).

When the British were injured by a tax procedure adopted under General Grant, the Court of Customs and Patent Appeals ignored the admonitions of Article II. Instead it assured the exporters that they could ship their products overproof (necessarily in bulk) "and have the commodity taxed accordingly" (Pet., p. A11).

How scant consolation that assurance provided foreign producers appears in the Report of the United States Tariff Commission on Whisky (Washington, March, 1958), p. 34:

> Only a small percentage of the total employment in the distilled liquor industry is engaged in the actual distillation of liquors; most employees are engaged in bottling, labeling, packing and distribution. Changes in employment, therefore, are more closely related to changes in bottled output than to changes in distilling.

The Times of London (June 25, 1963, p. 23, col. 5) watched with concern the way bulk exports to the United States

were replacing bottled goods and noted "The ultimate results need no stressing; they could be of profound significance for the economy of Scotland as a whole."

The Opportunities This Case Offers.

Importers, exporters, and possibly foreign governments, sometimes feel that they do not receive full consideration under the American judiciary system because of the infrequency with which the Supreme Court grants writs of certiorari to the Court of Customs and Patents Appeals. Counsel recognize that the demands on this Court preclude its considering cases defective on their face as it did in two petitions involving alcoholic beverages: *United States v. Rathjen*, 31 CCPA 70 (certiorari denied 320 U.S. 797) and *Bercut* (certiorari denied 359 U.S. 953). In *Rathjen* the protest was premature because the statute involved had no savings clause in favor of existing international obligations and in *Bercut* the importers sought excessive refunds under Article III by not limiting their claims to those after January 1, 1948, as the Protocol of Provisional Application required (Pet., pp. A 20-1). Here there is a savings clause and the claim is limited to charges after January 1, 1948. Moreover, the Brief in Opposition failed to find any errors in the points Petitioners present—as contrasted with those erroneously attributed to them.[1]

Here the case is not one of technical issues of importance primarily to the importers concerned, which an overworked Court must necessarily reject. Such errors if

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1. The Brief in Opposition (p. 7 n. 8) also erroneously states that petitioners ignored the rectification tax. As the Petition (p. 7 n. 8) explained, Petitioners limitation of their claim to the $1.50 increase by the Act of 1951 made that tax irrelevant. The Act did not increase the rectification tax and the savings by a proof gallon assessment on domestic products on a $9 tax more than offset it.

long continued in the domestic field usually are corrected on certiorari when serious conflicts of decisions in the circuits develop. In customs matters, such conflicts seldom arise because of the exclusive jurisdiction of the Court of Customs Appeals. Here, however, *Parrott* provides a clear conflict in principle as to what effect should be given to a provision substantially the same as Article II of the General Agreement.

In some cases, as in *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, action by the Judiciary may embarass the Executive Branch in its international dealings. But this is not an instance in which the Court is asked to sit in judgment on the acts of another government. Here the Court will only be correcting a decision of a subordinate American tribunal. So long as the decision stands it will provide a bulwark for those seeking protection and a handicap to those seeking to bring American practices into accord with those of other countries—and with the *Parrott* case concerning the Virgin Islands.

The judiciary is the branch of the government which interprets its laws. At present the law of the land with respect to Article II rests upon the fleeting consideration given it by the Court of Customs and Patent Appeals in *Bercut* (p. 32) and in this case (Pet., p. A12). That Court did not consider the standard rules of construction, the legislative history of the competing provisions, the evils which they sought to cure or the many other techniques experience has provided to assist in rendering sound judgments. Petitioners submit that past performance make it obvious that the Court of Customs and Patent Appeals will not reconsider its conclusions.

Petitioners urge that Article II has not had its day in court and will not unless this Court grants a writ of certiorari.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be granted.

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